

## CREDIT OPINION

4 October 2019



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# Louisville & Jefferson Co. Metro. Govt., KY

## Update to credit analysis

### Summary

[Louisville & Jefferson County Metro Government, KY](#) (Aa1 stable) benefits from a growing, sizeable and regionally significant tax base that serves as a major economic hub in the [Commonwealth of Kentucky](#) (Aa3 stable). Resident income levels are healthy, although slightly below the medians for the rating category. Louisville Metro's reserve and liquidity levels are satisfactory and, while they fall short of the national medians for the Aa1 rating category as a percentage of revenue, they have historically been stable, supported by conservative budgetary practices and adherence to formal fiscal policies. The government's credit profile also reflects manageable debt and pension burdens.

### Credit strengths

- » Sizeable and growing tax base serving as a regionally important economic hub
- » Stable financial operations
- » Manageable debt burden

### Credit challenges

- » Lower reserves and liquidity relative to national peers
- » Resident income levels below Aa1 median
- » Higher pension burden compared to medians for the rating category

### Rating outlook

The stable outlook reflects the improving and regionally important local economy and the likelihood that reserves and liquidity will remain stable due to management's willingness to implement expenditure reductions to maintain structural balance.

### Factors that could lead to an upgrade

- » Material and sustained improvement in reserve and liquidity levels
- » Substantial tax base growth and expansion coupled with improvement in resident incomes
- » Reduction in debt burden

## Factors that could lead to a downgrade

- » Reduction in operating flexibility and narrowing reserve levels
- » Material contraction in tax base and weakened income levels
- » Substantial increase in debt burden

## Key indicators

Exhibit 1

Louisville & Jefferson Co. Metro. Govt., KY	2014	2015	2016	2017	2018
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$79,922,269	\$81,876,791	\$86,326,372	\$89,280,860	\$95,908,835
Population	751,485	755,809	759,724	764,378	N/A
Full Value Per Capita	\$106,352	\$108,330	\$113,629	\$116,802	N/A
Median Family Income (% of US Median)	95.1%	95.3%	95.3%	96.8%	N/A
<b>Finances</b>					
Operating Revenue (\$000)	\$613,175	\$654,871	\$682,616	\$772,072	\$719,373
Fund Balance (\$000)	\$78,559	\$92,880	\$104,213	\$103,110	\$106,259
Cash Balance (\$000)	\$66,052	\$77,015	\$89,652	\$94,880	\$86,936
Fund Balance as a % of Revenues	12.8%	14.2%	15.3%	13.4%	14.8%
Cash Balance as a % of Revenues	10.8%	11.8%	13.1%	12.3%	12.1%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$487,128	\$491,967	\$636,152	\$645,172	\$687,340
3-Year Average of Moody's ANPL (\$000)	\$1,320,335	\$1,240,905	\$1,263,546	\$1,411,925	\$1,551,740
Net Direct Debt / Full Value (%)	0.6%	0.6%	0.7%	0.7%	0.7%
Net Direct Debt / Operating Revenues (x)	0.8x	0.8x	0.9x	0.8x	1.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.7%	1.5%	1.5%	1.6%	1.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.2x	1.9x	1.9x	1.8x	2.2x

Source: Louisville & Jefferson County Metro. Govt. Audited Financial Statements, U.S. Census American Community Survey, Moody's Investor's Service

## Profile

Louisville Metro is an important regional metropolitan center located in the bluegrass region of the [Commonwealth of Kentucky](#) (Aa3 stable), approximately 80 miles west of [Lexington-Fayette Urban County Govt., KY](#) (Aa2 stable), that supports a variety of industries including manufacturing and logistics. Louisville Metro encompasses 397.7 square miles and has a 2017 population of 764,378 according to the most recent U.S. Census American Community Survey, which represents a 3.1% increase from 2010.

## Detailed credit considerations

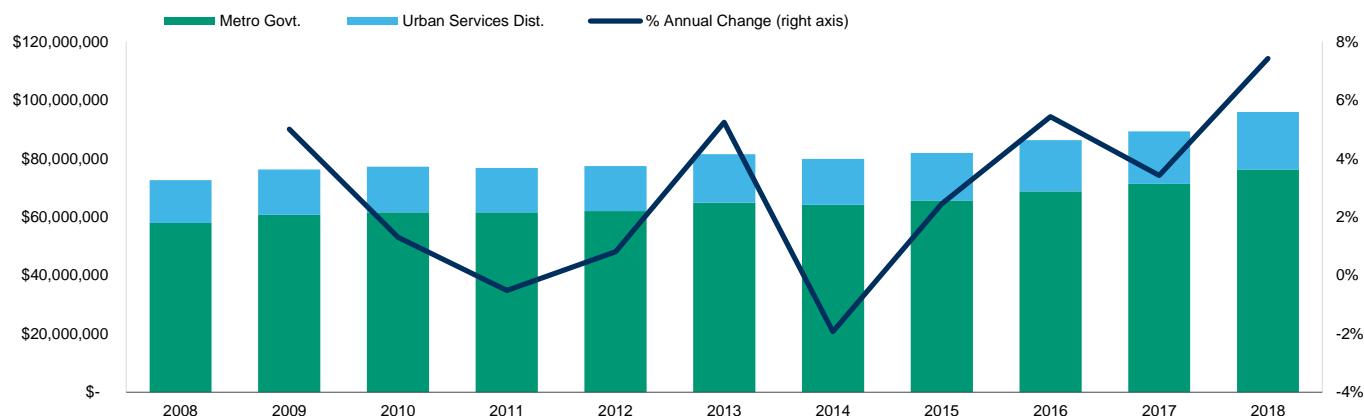
### Economy and Tax Base: Sizeable and Regionally Significant Tax Base

Louisville & Jefferson County Metro Government's sizeable tax base will continue to experience steady growth, driven by new development and property value appreciation. The tax base grew by 7.4% in fiscal 2018 to \$95.9 billion (combined estimated actual value of the Metro area and Urban Services District), which is large compared to the national medians for the Aa1 rating category.

Louisville Metro serves as a major employment hub for residents of Jefferson County and surrounding adjacent areas of the Commonwealth, as well as southern Indiana. The local economy is diverse, but largely driven by manufacturing, transportation, healthcare, and various professional services given the city's favorable access to several interstate highways (I-65, I-64 and I-71).

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Exhibit 2

**Sizeable tax base continues to exhibit healthy annual growth (\$000)****5-year average annual growth rate of 3.4% (fiscal years 2014-2018)**

Combined Metro Government and Urban Services District Total Estimated Actual Values (Full Values)

Source: Louisville Metro Audited Financial Statements; Moody's Investors Service

Major employers include [United Postal Service, Inc.](#) (UPS, A2 negative), [Ford Motor Company](#) (Ba1 stable), GE Appliances ([General Electric Company](#), Baa1 stable), and [Humana, Inc.](#) (Baa3 stable). Recent announcements include expansions at UPS' Centennial Hub/Worldport Facility, a \$550 million investment by Ford Motor Company at their two assembly plants, and a \$200 million investment by GE Appliances that is slated to create 400 jobs.

Additionally, the Kentucky International Convention Center recently reopened in August of 2018 following substantial renovations, which has spurred the renovation and construction of several hotels downtown including a new Moxy Hotel, which is an \$80 million investment. Louisville Metro also benefits from the institutional presence of the [University of Louisville](#) (A3 negative), which has an enrollment (full-time equivalent) of nearly 18,500 students.

Louisville Metro's August 2019 unemployment rate of 4.1% is comparable to the state (4.3%) and national (3.8%) rates for the same period. Additionally, the government's population growth has been steady, increasing by 3.1% since 2010 to 764,378 in 2017, according to the most recent U.S. Census American Community Survey. Resident income levels are healthy with median family income equal to 96.8% of the US in 2017, but are lower than similarly-rated peers nationwide.

### Financial Operations and Reserves: Stable Financial Operations; Satisfactory Reserves and Liquidity

Louisville Metro's financial position will remain stable, despite pressure from mandated expenditure growth, as local economic expansion continues to drive increases in core revenues and management continues to make budgetary adjustments necessary to maintain balanced operations.

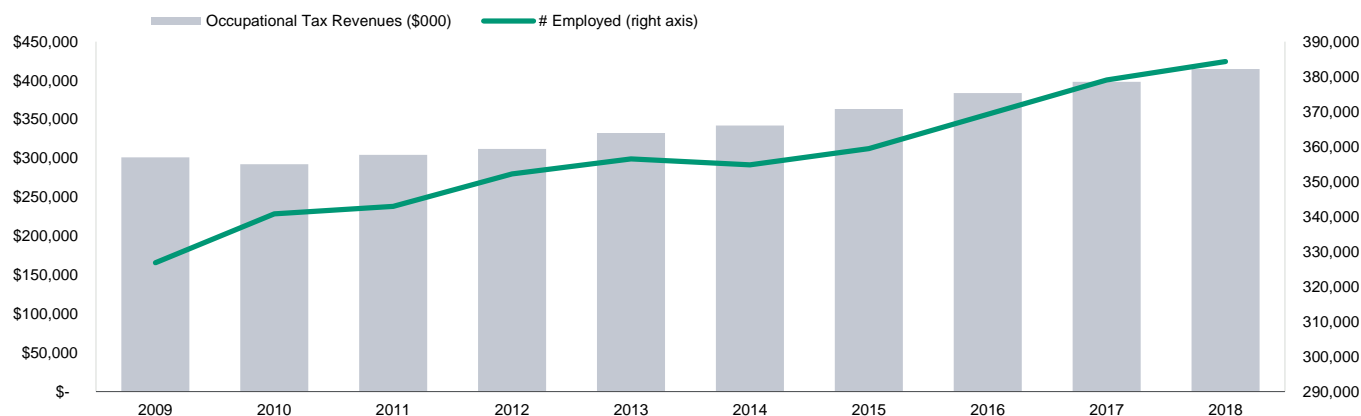
At fiscal year-end 2018, total operating fund balance (inclusive of both the general and debt service fund) increased slightly to \$107.7 million, or 15.0% of combined operating fund revenues, which is sizeable on an absolute level but below the national Aa1 median as a percentage of revenues. Available operating fund balance (unassigned, assigned, and committed portions) was 14.8% for fiscal 2018. Over the past five fiscal years, the government's available fund balance has remained relatively stable, averaging 14.1% of revenues.

The government's primary revenue sources are occupational license fees (inclusive of a payroll withholding, a net profits tax, and an insurance premiums tax) and property taxes, which represented approximately 58% and 23% of operating fund revenues in fiscal 2018, respectively.

Exhibit 3

**Occupational tax revenue growth driven by continued gains in employment**

5-year average annual growth rate of 4.5% for Occupational Tax Revenues (fiscal years 2014-2018)



Source: Bureau of Labor Statistics, Louisville Metro Audited Financial Statements; Moody's Investors Service

Unaudited results for fiscal 2019 show the year ending with a modest increase in unassigned general fund balance. The increase in fund balance was largely driven by the midyear implementation of expenditure controls (slowdown in hiring and reduction of discretionary expenditures) in response to a projected revenue shortfall and impending pension contribution increases. Preliminary fiscal 2019 results show Louisville Metro will likely meet or exceed the budgeted \$500,000 increase to unassigned fund balance due to strong net profits revenues in May and June.

Faced with a budgetary shortfall in fiscal 2020, management first approached Metro Council for an increase in the insurance premium tax to help offset escalating expenditures, notably for pensions costs and salary increases. Following Metro Council's rejection of any revenue enhancements, Metro Government adopted an annual 4% property tax rate increase for the second year, the highest it can implement without being subject to voter recall. Further, the management team made multiple expenditure cuts, resulting in a balanced budget in fiscal 2020 with no use of reserves.

Pension costs are likely to increase by up to 12% annually over the next several years, which will likely require further expenditure reductions and/or revenue enhancements. Future reviews of the government's rating will focus on management's ability to maintain reserve levels at or above current levels as it absorbs these additional costs.

**LIQUIDITY**

Louisville Metro's operating funds (inclusive of both the general and debt services fund) reported net cash and investments of \$86.9 million at fiscal year-end 2018, or a satisfactory 12.1% of combined operating fund revenues, which is satisfactory but below the national Aa1 median as a percentage of revenues. Operating fund cash has averaged 12.0% of revenues over the past five fiscal years.

**Debt and Pensions: Debt Burden Will Remain Manageable Despite Additional Borrowing Plans**

Louisville Metro's direct debt burden will remain manageable, despite future debt plans. The government's direct debt burden represents approximately 0.7% of fiscal 2018 full valuation, which is a level comparable to the national medians for the Aa1 rating category. The city's net direct debt reflects 98% support from the Kentucky Administrative Office of the Courts (AOC) on the city's Series 2007A lease revenue bonds. The fiscal 2019 capital budget authorized \$82.9 million of additional general obligation debt for various capital improvements and economic development initiatives. Following the current \$45 million issuance, there will be \$37.9 million remaining under the 2019 authorization. The fiscal 2020 capital budget authorizes an additional \$53.5 million of additional general obligation debt.

In 2008, the Kentucky Economic Development Authority issued \$350 million of revenue bonds to fund the acquisition, development, construction and financing of an arena in downtown Louisville. Pursuant to an ordinance adopted by the Metro Council, the city agreed to pay up to \$309 million to the Louisville Arena Authority for debt service on the bonds over a 30-year period. The authority refunded the 2008 revenue bonds in 2017 and entered into a new agreement with Louisville Metro where they agreed to pay \$10.8 million annually directly to the trustee until the earlier of 2054 or until the debt is repaid.

**DEBT STRUCTURE**

All of the government's debt is fixed rate and amortized over the long-term.

**DEBT-RELATED DERIVATIVES**

The government is not party to any interest rate swaps or other derivative agreements.

**PENSIONS AND OPEB**

Louisville Metro administers two closed single-employer pension plans, the Policemens' Retirement Fund and the Firefighters' Pension Fund. Additionally, the government participates in the Kentucky County Employees' Retirement System (CERS), a multi-employer cost sharing pension plan administered by the Kentucky Retirement System.

The total pension contribution for fiscal 2018 totaled \$63.2 million, which was just 87.6% of the tread water amount (the amount required to prevent the unfunded liability from increasing based on plan assumptions).

Moody's adjusted net pension liability (ANPL) is our measure of a local government's pension burden that uses a market-based interest rate to value accrued liabilities. The government's ANPL has averaged \$1.6 billion over the last three years, representing 2.2 times operating revenues, which is slightly above the national medians for the rating category. Our ANPL is based on a discount rate of 3.87%, compared to the discount rate of 6.26% used to calculate the reported GASB net pension liability of \$972.0 million.

Louisville Metro also provides employees with other post-employment benefits (OPEB) through a mutli-employer defined benefit plan administered by the state (CERS). The Moody's adjusted net OPEB liability was \$591.2 million at fiscal year-end 2018. The OPEB contribution in 2018 totaled \$23.1 million.

Total fixed costs (inclusive of pension and OPEB contributions and debt service) account for 21.4% of revenues in fiscal 2018. Total long-term liabilities (adjusted pension and OPEB liabilities for fiscal 2018 and net direct debt burden) represent 3.0% of 2019 full value.

**Management and Governance**

Louisville & Jefferson County Metropolitan Government is a merged city/county form of government created in 2003. The city is governed by a 26 member council elected to staggered, four-year terms and a mayor elected to a four-year term. The city has a formal policy to maintain unassigned fund balance at one to two months of budgeted general fund expenditures.

Kentucky cities have an institutional framework score of "Aa," or strong. Property and occupational license taxes, the primary revenue sources, are highly predictable. Cities have moderate revenue-raising ability and can increase property taxes by 4% annually. Cities with populations of 15,000 and above also have a property tax cap of 15 mills. Cities with population of 1,000 or higher have the power to levy an occupational license tax. The tax rate is unlimited for cities with populations up to 300,000 and capped at 1.25% for larger cities. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Expenditures are highly predictable and cities have a moderate ability to reduce them given a limited presence of unions and moderate fixed costs. Fixed costs are driven mainly by debt service and pension costs.

## Rating methodology and scorecard factors

Exhibit 4

Louisville &amp; Jefferson Co. Metro. Govt., KY

Rating Factors	Measure	Score
Economy/Tax Base (30%) <sup>[1]</sup>		
Tax Base Size: Full Value (in 000s)	\$95,908,835	Aaa
Full Value Per Capita	\$124,370	Aa
Median Family Income (% of US Median)	96.8%	Aa
Notching Factors: <sup>[2]</sup>		
Institutional Presence		Up
Regional Economic Center		Up
Finances (30%)		
Fund Balance as a % of Revenues	14.8%	A
5-Year Dollar Change in Fund Balance as % of Revenues	4.4%	A
Cash Balance as a % of Revenues	12.1%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	3.8%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.7%	Aaa
Net Direct Debt / Operating Revenues (x)	1.0x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.6%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	2.2x	A
Notching Factors: <sup>[2]</sup>		
Unusually Strong or Weak Security Features		Up
Scorecard-Indicated Outcome		Aa1
Assigned Rating		Aa1

[1] Economy measures are based on data from the most recent year available

[2] Notching factors are specifically defined in the US Local Government General Obligation Debt methodology dated September 27, 2019

[3] Standardized adjustments in the GO Methodology Scorecard Inputs Updated for 2019 publication

Source: Louisville & Jefferson County Metro. Govt. Audited Financial Statements, U.S. Census American Community Survey, Moody's Investor's Service

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